Report

of the

Examination of

Crystal Lake-Utica Mutual Insurance Company

Berlin, Wisconsin

As of December 31, 1997

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November 6, 1998

Honorable Connie O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

CRYSTAL LAKE-UTICA MUTUAL INSURANCE COMPANY

Berlin, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1996 as of December 31, 1995. The current examination covered the intervening period ending December 31, 1997, and included a review of such 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employes' Welfare and Pension Plans
Territory and Plan of Operations
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was organized as a town mutual insurance company on December 27, 1875, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Crystal Lake Farmers' Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to Crystal Lake-Utica Mutual Insurance Company (hereinafter "the company" or "Crystal Lake").

Effective March 31, 1995, the company converted to an assessable mutual insurance company under Ch. 611. Concurrent with the conversion, the Commissioner issued a Stipulation and Order whereby the company and the Commissioner agreed to the following limitations and conditions:

1. That the company maintain a permanent surplus of $1,000,000 as reported in the annual statement. Surplus will be defined as the surplus as regards policyholders per the company's filed annual statement less any surplus aid obtained through reinsurance.

2. The company will limit its territory to Adams, Brown, Calumet, Columbia, Dane, Dodge, Fond du Lac, Green Lake, Juneau, Manitowoc, Marquette, Outagamie, Portage, Sauk, Shawano, Sheboygan, Waupaca, Waushara, Winnebago, and Wood counties.

3. That the various retention limits, stop loss, and catastrophic coverages under the company's reinsurance program prior to conversion shall continue to apply after conversion and shall be in compliance with statutes and rules applicable to town mutual insurers. That aggregate net losses under the company's umbrella excess liability program not exceed $100,000 in any one calendar year. That any changes to the reinsurance program be submitted to the Commissioner 30 days prior to the effective date, subject to disapproval.

4. The assessment liability of policyholders shall be one times the annual premium in force at the date of assessment.

5. The company shall maintain compulsory surplus of 50% of net written premium. Surplus will be as reported in the annual statement, less any surplus aid obtained through reinsurance.

6. The company shall be authorized to write the following lines: (2) (a) Fire, Inland Marine, and Other Property Insurance; (2) (d) Liability and Incidental Medical Expense Insurance [Other than Automobile and Aircraft Insurance as defined in section (2) (e)], and incidental nonowned and hired automobile coverage in endorsement to property policies written by the company, (2) (e) Automobile and Aircraft Insurance.

7. The company may write coverage (2) (d) only when supplemental to property insurance written under (2) (a).

8. The company may write (2) (e) only on an excess basis in conjunction with its umbrella excess liability program.

The Stipulation and Order was amended in 1997 to remove the requirement that surplus be reduced by surplus aid from reinsurance when determining compliance with the compulsory surplus amount.

The major products marketed by the company include farmowner's, homeowner's, and mobile homeowner's policies. The company also markets monoline dwelling policies on farms, homes, and commercial establishments, and umbrella liability coverages.

The major products are marketed through 44 agencies utilizing 144 independent agents, three of whom are directors of the company. The agent/directors write a combined total of 6% of the direct business of the company.

The following table is a summary of the net insurance premiums written by the company in 1997. The growth of the company is discussed in the Financial Data section of this report. It should be noted that the company cedes a significant portion of the direct premium written to its reinsurer.

Line of Business	Direct Premium Written	Reinsurance Ceded	Net Premium Written
Fire	$ 99,584	$ 65,003	$ 34,581
Allied lines	67,532	44,081	23,451
Farmowner's multiple peril	560,693	375,129	185,564
Homeowner's multiple peril	484,337	331,937	152,400
Commercial multiple peril	380,335	297,422	82,913
Inland marine	81,592	53,259	28,333
Write-ins for other lines of business	13,243		13,243
Total All Lines	$1,687,316	$1,166,831	$520,485

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Officers are elected at the board's annual meeting. The board members currently receive an annual fee of $100.00, a $50.00 fee for meetings attended, and a $.325 per mile travel allowance for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Donald J. Buchholz Westfield, WI	Farmer and Insurance Agent	1999
Delbert Krause Berlin, WI	Service Station Owner	1999
Arnold Kretzmann Berlin, WI	Secretary/Treasurer and Insurance Agent	2000
Norman Weis Ripon, WI	Farmer and Cattle Buyer	2001
Milton Messerschmidt Montello, WI	Owner Small Engine Repair Shop	2001
James H. Tritt, Jr. Omro, WI	Farmer	2000
Arthur E. Dee Coloma, WI	Retired Banker and Insurance Agent	2000

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
Donald J. Buchholz	President	$ 700/year
Delbert Krause	Vice President	125/year
Arnold Kretzmann	Secretary/Treasurer	40,750/year
Marcia Finger	Assistant Treasurer	34,740/year

Mr. Kretzmann and Ms. Finger are father and daughter.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee

Arnold Kretzmann
Donald Buchholz
Milton Messerschmidt
Marcia Finger

Nominating Committee

Arthur E. Dee
James H. Tritt, Jr. - Alternate

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Ceding Contracts

1.	Type:	Combined Reinsurance Treaty
	Reinsurer:	Erie Insurance Exchange
	Scope:	All property policies written by the company.
	Retention:	Excess of Loss: $50,000 of the net loss including loss adjustment expenses. Quota Share: Zero retention of wind and hail losses; 68.5% of the first $50,000 on all other losses.
	Coverage:	Excess of loss: 100% of the amount in excess of $50,000 up to a limit of $200,000 for all losses other than wind and hail. Quota share: 100% of $50,000 for all wind and hail losses plus 31.5% of the first $50,000 of all other losses.
	Premium:	50% of net subject premium
	Commissions:	22.5% of the premium ceded
	Effective date:	January 1, 1995, continuous
	Termination:	By either party at the end of any calendar year with at least 90 days' prior written notice.
2.	Type:	Casualty Quota Share
	Reinsurer:	Erie Insurance Exchange
	Scope:	All liability lines written by the company
	Retention:	10% of the net liability including loss adjustment expenses arising from covered risks; however, on losses less than $1,000 the company retains all liability.
	Coverage:	90% of the net liability including loss adjustment expense to a maximum of 90% of $25,000 per occurrence.
	Premium:	90% of the subject premium

	Commissions:	20% of the above amount with a contingent commission of 40% of the net profit related to this contract.
	Effective Date:	January 1, 1995, continuous
	Termination:	By either party at the end of any calendar year with at least 90 days' prior written notice.
3.	Type:	Casualty Excess of Loss
	Reinsurer:	Excess Mutual Reinsurance Company
	Scope:	All liability lines written by the company
	Retention:	$25,000 from any one loss occurrence
	Coverage:	100% of the excess of the company's retention including loss adjustment expenses and extra contractual obligations, up to a limit of $500,000.
	Premium:	53% of the total net subject premium
	Effective Date:	January 1, 1985, continuous
	Termination:	At any time by either party with at least 90 days' prior written notice.
4.	Type:	Aggregate Excess of Loss
	Reinsurer:	Erie Insurance Exchange
	Scope:	Business classified as property and casualty
	Retention:	The greater of 75% of the company's net premium earned during the calendar year; or $350,000 plus 5% of the remaining 25% of net premiums earned. In addition, the limit with respect to the casualty business shall be the lesser of $200,000 or 20% of surplus the preceding December 31.
	Coverage:	95% of the excess of the retention, limited to the lesser of 95% of net premiums earned or 95% of $700,000.
	Premium:	8% of net premiums earned subject to an annual minimum premium of $35,800.
	Effective Date:	January 1, 1995, continuous
	Termination:	By either party at the end of any calendar year with at least 90 days' prior written notice.

The company also has excess catastrophe coverage and obtains facultative reinsurance with various authorized reinsurers for risks that exceed the limits listed in the above contracts. Reinsurance is obtained through Balis and Company acting as broker.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1997, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Surplus per Examination." Also included in this section are schedules which reflect the growth of the company and the compulsory and security surplus calculation. Because the company has not filed its financial statements with the NAIC, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination have not been included.

Crystal Lake - Utica Mutual Insurance Company
Assets
As of December 31, 1997

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$228,716	$	$	$228,716
Stocks:				
Preferred stocks	539,071			539,071
Common stocks	166,118			166,118
Real estate:				
Occupied by the company	133,065			133,065
Cash	198,292			198,292
Short-term investments	25,000			25,000
Write-ins for invested assets:				
Mutual Insurance Company Note		500	500	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	(137,792)			(137,792)
Premiums, agents' balances, and installments booked but deferred and not yet due	44,807			44,807
Reinsurance recoverables on loss and adjustment payments	206,210			206,210
Electronic data processing equipment	2,223			2,223
Interest, dividends, and real estate income due and accrued		15,716		15,716
Other assets nonadmitted:				
Equipment, furniture, and supplies		7,713	7,713	
Write-ins for other than invested assets				
Prepaid insurance		1,537	1,537	
Total Assets	$1,405,710	$25,466	$9,750	$1,421,426

Crystal Lake - Utica Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 1997

Losses	$ 59,304
Reinsurance payable on paid loss and loss adjustment expenses	
Loss adjustment expenses	3,380
Contingent commissions and other similar charges	9,600
Other expenses (excluding taxes, licenses, and fees)	2,575
Taxes, licenses, and fees (excluding federal and foreign income taxes)	4,724
Unearned premiums	321,423
Amounts withheld or retained by company for the account of others	3,278
Write-ins for liabilities:	
Advance premiums	30,757
Total Liabilities	435,431
Surplus as Regards Policyholders	985,995
Total Liabilities, Surplus, and Other Funds	$1,421,426

Crystal Lake - Utica Mutual Insurance Company
Summary of Operations
For the Year 1997

Underwriting Income	
Premiums earned	$ 527,320
Deductions	
Losses incurred	264,023
Loss expenses incurred	107,919
Other underwriting expenses incurred	295,532
Total underwriting deductions	667,494
Net underwriting gain or loss	(140,174)
Investment Income	
Net investment income earned	76,872
Net realized capital gains or losses	(5,648)
Net investment gain or loss	71,224
Other Income	
Write-ins for miscellaneous income:	
Miscellaneous	40
Total other income	40
Net income before dividends to policyholders and before federal and foreign income taxes	(68,910)
Net income after dividends to policyholders but before federal and foreign income taxes	(68,910)
Net Loss	$ (68,910)

Crystal Lake - Utica Mutual Insurance Company
Cash Flow
As of December 31, 1997

Premiums collected net of reinsurance	$527,329		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	494,608		
Underwriting expenses paid	296,011		
Cash from underwriting		$(263,290)	
Investment income (net of investment expense)		79,324	
Other income (expenses):			
Net amount withheld or retained for account of others	(84)		
Write-ins for miscellaneous items:			
Miscellaneous income	40		
Total other income		(44)	
Net cash from operations			$(184,010)
Proceeds from investments sold, matured, or repaid:			
Bonds	129,960		
Stocks	23,294		
Other invested assets	500		
Total investment proceeds		153,754	
Cost of investments acquired (long-term only):			
Bonds	20,000		
Stocks	30,000		
Total investments acquired		50,000	
Net cash from investments			103,754
Cash provided from financing and miscellaneous sources:			
Other cash provided	14,514		
Total		14,514	
Cash applied for financing and miscellaneous uses:			
Other applications	3,785		
Total		3,785	
Net cash from financing and miscellaneous sources			10,729
Net change in cash and short-term investments			(69,527)
Reconciliation			
Cash and short-term investments, December 31, 1996			292,819
Cash and short-term investments, December 31, 1997			$ 223,292

Crystal Lake - Utica Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1997

The company is required under Stipulation and Order 95-C24130 to maintain a permanent surplus of $1,000,000 and a compulsory surplus of 50% of all net written premiums during any 12-month period. Surplus is defined as surplus as regards policyholders as reported in the financial statements filed with the Commissioner.

Assets		$1,421,426	
Less liabilities		435,431	
Adjusted surplus			$ 985,995
All other insurance	$520,485		
Factor (per order)	50%		
Total		260,090	
Permanent surplus			1,000,000
Permanent surplus excess (or deficit)			(14,005)

The company has failed to meet its permanent surplus order in 1997.

Crystal Lake - Utica Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 1997

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1993	**1994**	**1995**	**1996**	**1997**
Surplus, beginning of year	$1,357,257	$1,347,976	$1,123,385	$1,031,622	$1,023,722
Net income	5,241	(148,325)	(157,508)	(21,315)	(68,910)
Net unrealized capital gains or (losses)	1,192	(78,655)	60,565	8,262	29,643
Change in nonadmitted assets	(15,714)	2,389	5,180	5,153	1,540
Surplus, end of year	$1,347,976	$1,123,385	$1,031,622	$1,023,722	$985,995

Growth of Crystal Lake - Utica Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policy holders	Net Income
1993	$2,019,711	$671,735	$1,347,976	$ 5,241
1994	1,739,519	616,134	1,123,385	(148,325)
1995	1,684,202	652,580	1,031,622	(157,508)
1996	1,452,592	428,870	1,023,722	(21,315)
1997	1,421,426	435,431	985,995	(68,910)

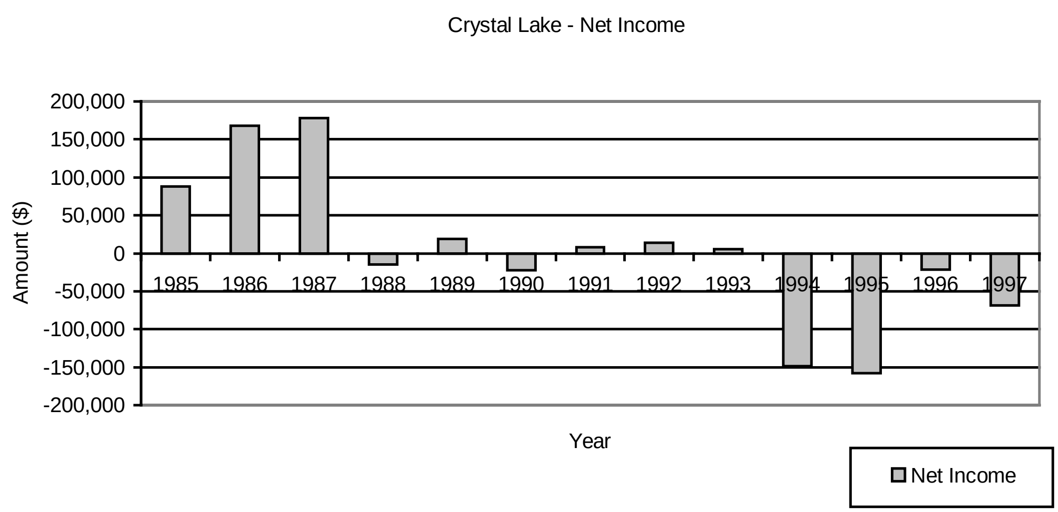
Year	Gross Premium Written	Net Premium Written	Premium Earned	Net Loss And LAE Ratio	Net Expense Ratio	Combined Ratio
1993	$1,532,187	$545,967	$545,700	75.8%	44.6%	120.4%
1994	1,602,091	537,608	520,483	83.3	61.7	145.0
1995	1,515,025	503,179	512,290	95.6	55.6	151.2
1996	1,620,875	561,332	542,859	62.8	54.6	117.4
1997	1,687,316	520,485	527,320	70.5	56.8	127.3

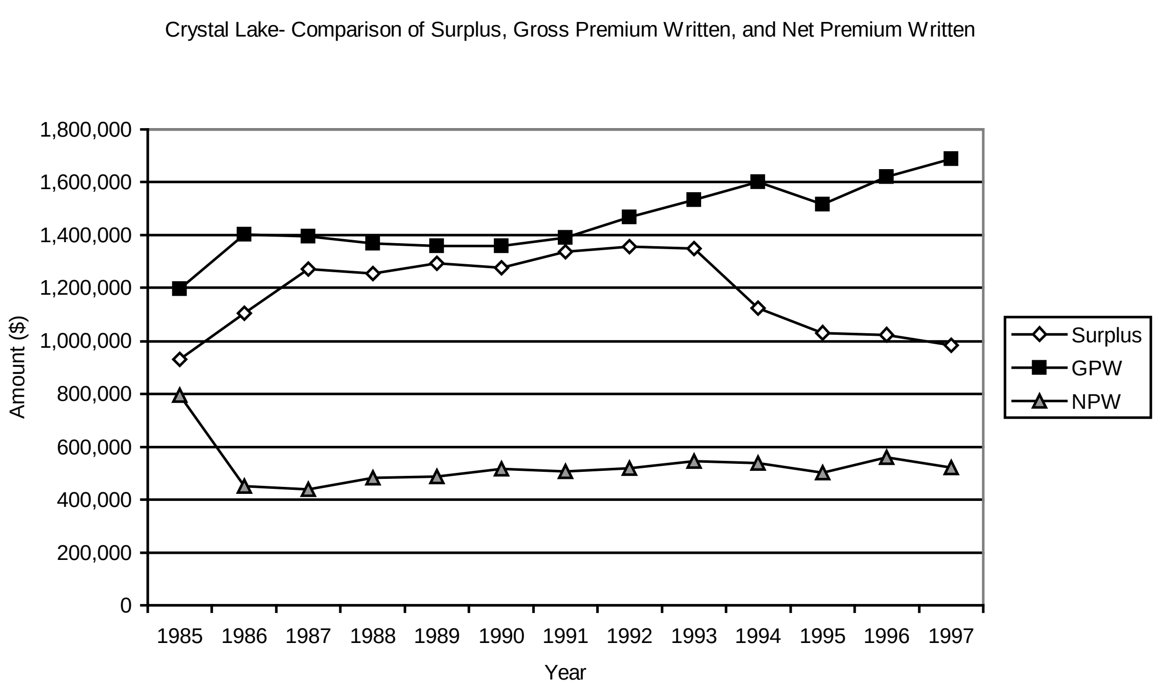
Although the examination period covered only the past two years, the results of the past five years are being included to show the company's recent financial trends.

Over the past five years, the company has shown signs of decline. Assets and surplus have decreased over the past five years. Net losses have been incurred in four of the past five years. The net loss, expense, and combined ratios have all been high. The loss ratio and combined ratio both showed improved results in 1996 and 1997. However, even with these results, the company reported net operating losses.

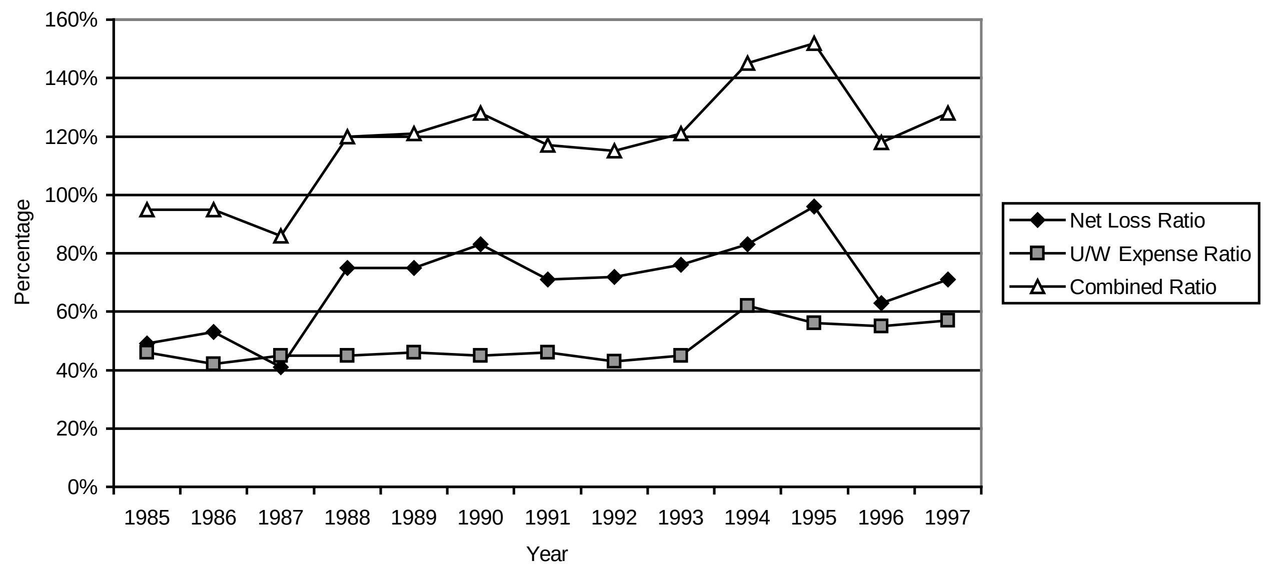
The main reason for these results is the high expense ratio, which is a direct result of its high ceding rate combined with low ceding commissions. Before reinsurance, the company incurred approximately $600,000 in direct expenses while writing $1.7 million in direct premium, resulting in a direct expense ratio of 37%. However, the company cedes approximately two-thirds of the gross premium written and receives rates of 0% to 22.5% ceding commissions on this business, which does not adequately cover the company's direct expenses related to acquiring and maintaining the business. This is evidenced in the high net expense ratios of the past five years and the declining amounts of ceding commissions. On a comparative basis, Wisconsin companies of similar size and type cede about one-third of the gross premium written and have significantly lower direct and net expense ratios. The high expense ratio can also be partially attributed to the high commissions paid to the agents writing for the company. The company pays, on average, a 16% commission. It is virtually impossible for a small property and casualty insurance company to earn net incomes with net expense ratios in the 54% to 62% range as Crystal Lake has had from 1994 to 1997.

The following graphs depict the trends the company has been experiencing.

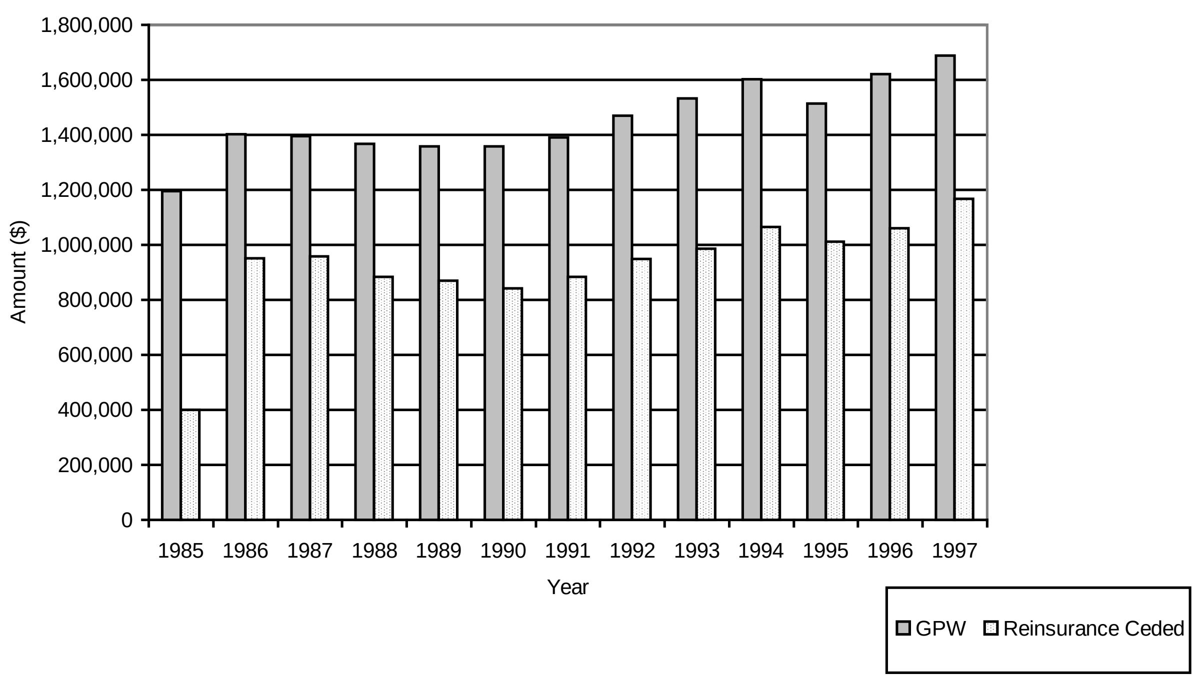




Crystal Lake - Comparison of Key Ratios



Crystal Lake - Gross Premium Written to Reinsurance Ceded



Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus between that reported by the company and as determined by this examination:

Surplus December 31, 1997, per annual statement			$985,995
	Increase	**Decrease**	
Contingent Commissions	$	$4,588	
Net increase or (decrease)	$	$4,588	4,588
Surplus December 31, 1997, per examination			$981,407

Examination Reclassifications

	Debit	**Credit**
Other Expenses	$407	$
Taxes, Licenses, and Fees		407
Total reclassifications	$407	$407

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 14 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., concerning the custody and control of its invested assets.

   Action—Compliance.

2. Invested Assets—It is recommended that the company submit the proper filings to the NAIC Securities Valuation Office for those securities not listed in the Valuations of Securities manual.

   Action—Noncompliance.

3. Stocks—It is recommended that the company complete Schedule D using the market values in the Valuations of Securities.

   Action—Noncompliance.

4. Real Estate—It is recommended that the company include in both its income and expenses an amount for rent relating to its occupancy of its own building, in accordance with the Accounting Practices and Procedures Manual For Property/Casualty Insurance Companies.

   Action—Compliance.

5. Agents' Balances—It is again recommended that the company follow the Accounting Practices and Procedures Manual For Property/Casualty Insurance Companies concerning the proper netting of reinsurance balances in future annual statements.

   Action—Compliance.

6. Agents' Balances—It is recommended that the company include contingent commissions which are based on loss experience in "Contingent Commissions and Other Similar Charges," in accordance with the Accounting Practices and Procedures Manual For Property/Casualty Insurance Companies.

   Action—Compliance.

7. Liabilities—It is recommended that the company report "Other Expenses," "Taxes, Licenses, and Fees," and "Amounts Withheld or Retained By Company For Account of Others" in accordance with the Annual Statement Instructions-Property and Casualty.

   Action—Partial compliance, see comments in the summary of current examination results.

8. Unearned Premiums—It is recommended that the company produce and maintain work papers for the ceded unearned premium balance in Schedule F - Part 3.

   Action—No longer applicable as the company is no longer required to reduce surplus by surplus aid in the compulsory surplus calculation.

9. Losses—It is recommended that the company follow the Annual Statement Instructions-Property/Casualty, in filling out Schedule P on a carry-forward basis from accident year 1995 in future annual statements.

   Action—Partial compliance, see comments in the summary of current examination results.

10. Losses—It is recommended that the company promptly record the payment of all losses including those eligible for recoveries through facultative reinsurance.

    Action—Compliance.

11. Losses—It is recommended that the company review and modify its procedures for the calculation of loss adjustment expenses.

    Action—Compliance.

12. Compulsory Surplus—It is recommended that the company complete its Property & Casualty Compulsory and Security Surplus Calculation form in accordance with the Stipulation and Order.

    Action—Compliance.

13. Permanent Surplus—It is recommended that the company file a business plan with the Commissioner outlining what steps it will take to comply with the Stipulation and Order requiring the company to maintain a permanent surplus of $1,000,000.

    Action—Partial compliance, see comments in the summary of current examination results.

14. NAIC Filings—It is recommended that the company file its annual statements with the NAIC, or request the Commissioner for an exemption.

    Action—Compliance.

Summary of Current Examination Results

Current examination findings and recommendations made therein include the following:

Annual Statement

It was noted during the examination that the company has an assistant treasurer. However, this person is not named on the jurat page of the annual statement. In accordance with the NAIC Practices and Procedures Manual-Property and Casualty, officers, directors, and trustees should be included on the jurat page of the annual statement. Therefore, it is recommended that the company properly complete the jurat page of the annual statement by including all directors and officers of the company.

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period. It was noted that the company appoints an adjusting committee annually. This committee is to supervise the adjustment of losses and review claims paid to ensure the company is properly paying claims. There were no records of any meetings held or minutes kept by this committee to demonstrate whether this committee carried out its stated purpose. The secretary/treasurer stated this committee meets rarely if at all and was only appointed as required by statute for town mutual insurers. It is recommended that the company maintain minutes for committee meetings and that the minutes be approved by the board of directors and included with the minutes of the board of directors meetings. It is further recommended that the company appoint committees to carry out a purpose and that these committees have meetings.

It was also noted that the process by which the company nominates directors does not agree to the procedure as outlined in the company bylaws. The bylaws require the board to appoint a nominating committee consisting of three directors and to post a list of nominated persons at the company office. The board appoints the committee; however, it does not consist of three directors and a list is not posted at the company office. It is recommended that the company either amend its bylaws, with member approval, to reflect the actual nomination procedure followed, or follow the procedure as outlined in the bylaws.

During the period under examination, two directors could not complete their terms of office. There was no record in the minutes of the board of directors regarding the filling of these vacancies for the interim period. According to the company's bylaws, a vacancy "occurring between annual meetings of the members shall be filled by a majority vote of the remaining members of the Board of Directors at a meeting called for that purpose." The company has since resolved this problem by amending the bylaws and changing the number of directors from nine to seven. However, these vacancies occurred before the bylaw change; therefore, it is recommended that the company follow the procedures established in the bylaws for filling vacancies on the board when/if a vacancy should occur in the future.

Conflict of Interest

Crystal Lake has adopted procedures for the disclosure of potential conflicts of interest of board members and other key employes. However, it was noted that two of the key employes/officers did not disclose a potential conflict of interest. The potential conflict is that these key employes/officers are related by marriage to an agent of one of the company's largest agencies. It is recommended that the company's directors and other key employes disclose all potential conflicts of interest on the conflict of interest statement disclosures.

Executive Compensation Form

In reviewing the company's report of executive compensation, several errors were noted. First, the amount reported for the secretary's salary was reported in total as salary when it should have been broken out between salary and other compensation. Second, for the directors, which includes the officers, only the amount paid to them as director fees was reported. The report should have included the salary amount paid to the president and vice-president. Also, the additional compensation paid to the directors for all other meetings should have been reported as "All Other Compensation." Therefore, it is recommended that the company properly complete the Report on Executive Compensation and include all amounts paid to directors and officers.

Business Plan

At the time of the examination, the business plan (deficit correction plan) in effect was one that was submitted to this office at our request in 1997. This business plan was not complete. A complete business plan would indicate:

- the company's long-term goals,
- the strategy for attaining those goals,
- the goals the company will seek to attain over a specified number of years, usually a five-year period,
- an analysis of the company's strengths and weaknesses,
- an analysis of the economic forces affecting the company,
- the company's investment strategy,
- the growth expected, and how this will be achieved,
- the company's underwriting and pricing strategies,
- the company's reinsurance strategy,
- a budget for expenses, and
- pro forma financial statements projecting anticipated operating results.

For this company, the business plan should also contain specific actions the company will take to come into compliance with the $1,000,000 minimum surplus requirement contained in the order issued to the company upon its conversion to an assessable mutual insurer. It should also address each of the major findings of this examination and the plan to comply with these findings.

The secretary/treasurer indicated that he is contemplating retirement in 1999. Considering this, the company should develop a management succession plan to assure continuity of knowledge and skills. The management succession plan should include:

- the specific plans for training the new manager and staff,
- the specific areas of responsibility of each employe,
- a description of the job duties, and
- the role of the board of directors in the management change.

It is recommended that the company establish a formal business plan, which includes the items noted in the preceding paragraphs, that is reviewed and approved by the board of directors. It is suggested that the company hire an outside consultant to assist in devising the business plan.

Budget

In conjunction with the business plan, an operating budget should be developed. This budget should include all direct expenses for the company. The budget should be reviewed periodically, at least quarterly, and compared to actual results. Areas that are operating above the budgeted amount should be reviewed extensively with appropriate changes made. Therefore, it is recommended that the company implement a budget in conjunction with the business plan, both of which should be periodically reviewed and approved by the board of directors and compared with actual results.

Audited Financial Statements

According to s. Ins 50.08 (2), Wis. Adm. Code, "an accounting firm partner or other person responsible for rendering a report required of an independent certified public accountant" may not act in that capacity for more than seven years. The engagement partner of the company's accounting firm has served as such since 1982 according to the December 1997 audit report. Therefore, the company is in violation of s. Ins 50.08 (2), Wis. Adm. Code. It is recommended that the company, in accordance with s. Ins 50.08 (2), Wis. Adm. Code, either require the accounting firm to rotate the partners engaged to perform the audit, request an exemption from the rotation requirement on the basis of unusual circumstances, or obtain a different certified public accounting firm to perform the audit.

Pursuant to s. Ins 50.11, Wis. Adm. Code, notification of adverse financial condition, an insurer is required to have its public accounting firm notify the board of directors, in writing, and within five business days, that the insurer does not meet minimum capital and surplus or compulsory surplus requirements. This notification should then be submitted to the Commissioner within five business days of its receipt by the board. The company has not met its $1,000,000 minimum surplus requirement and no formal notification as required by the

Administrative Code was made to the Board or to this office. Therefore, the company is and has been in violation of s. Ins 50.11, Wis. Adm. Code. It is recommended that the company and its accounting firm comply with s. Ins 50.11, Wis. Adm. Code, by properly reporting, to all relevant parties, adverse financial conditions of the company.

In accordance with s. Ins 50.06, Wis. Adm. Code, regarding contents of audited financial reports, the notes to the financial statement should include all notes required by the NAIC in accordance with the NAIC Annual Statement Instructions-Property and Casualty, and any notes required by generally accepted accounting principles. The notes should also include a reconciliation of differences between the audited financial statements and the filed annual statement. The audited financial statements filed with this office do not include:

- detailed information regarding such significant areas of the company's operations as investments and reinsurance.
- sufficient detail regarding the differences between statutory practices and generally accepted practices.
- notes regarding federal income taxes, nonadmitted assets, and any related party transactions.

The audited financial statements also did not include a reconciliation, as required, for differences between the financial statements and the annual statement. Therefore, it is recommended that the company comply with s. Ins 50.06, Wis. Adm. Code, and properly include all required footnotes to the financial statements in accordance with the NAIC Annual Statement Instructions-Property and Casualty and with generally accepted accounting principles.

Reinsurance

The reinsurance program consists of six treaties, which cover all lines of business written by the company. The net retention of the company for the types of business written is $2,500 for all casualty business, $0 for windstorm coverages, and $34,250 for all other property coverages. Under this program, the company cedes approximately two-thirds of the gross premium written. This results in a large percentage of the premium income being ceded to the reinsurer.

Of these six treaties, the company receives ceding commissions on two of the treaties. It receives a 22.5% commission rate on the combined treaty and a 20% commission rate, plus a 40% contingent commission on the net profits, on the casualty quota-share treaty. With the high cession rate and the low ceding commissions, the company does not retain sufficient net premium to cover the costs of acquiring and maintaining the business.

With the high expense ratio, the company cannot expect to be profitable. A comprehensive evaluation of the company's reinsurance should be made. It is recommended that the company retain a reinsurance consultant to analyze and evaluate the current reinsurance program, loss patterns, and claims database and to assist the company in developing a reinsurance program that would provide the company with the following: coverages as required by the Order, sufficient loss protection, and sufficient retention levels, and adequate ceding commissions to account for related expenses. This office should be notified of the individual selected for the evaluation.

Underwriting

An extensive review of the underwriting function of the company was performed during this examination. Areas of deficiency were noted and are as follows:

Age of dwelling: The examiners found that the company's Homeowners Underwriting Guide, sections 5. A. and 5. B. includes a requirement that a dwelling may not exceed 25 years of age to qualify for its Crystal Supreme homeowners product and 50 years of age to qualify for its Preferred homeowners product. Section Ins 6.68, Wis. Adm. Code, states that it is an unfair trade practice to use the age of a dwelling to refuse coverage or limit the amount of coverage, unless it is used for a business purpose that is not a mere pretext for unfair discrimination. It is recommended that the company revise its underwriting criteria to remove the use of the age of the dwelling as a criteria necessary to gain coverage under its various plans of insurance, in accordance with Ins 6.68 (3) (b), Wis. Adm. Code.

Form Changes: The examination included a review of the forms used by the company. The following problems were noted during the review and were submitted to the company for comment. The company could use a Wisconsin Amendatory Endorsement to correct the language of the forms listed below. However, the company did not submit such an endorsement for review by the examiner.

1. For the following refer to form MP 00 90 (Ed. 07 77).

    Refer to General Condition 3, Cancellation. Section 631.36, Wis. Stat, deals with cancellation, nonrenewal, and renewal with altered terms. A policy is required to contain provisions complying with this section which set forth the manner in which an insurer may cancel, nonrenew, or renew the policy with altered terms, including when notices must be sent or delivered to the insured. Your policy does not contain these provisions.

    Refer to General Condition 6, Subrogation. In situations involving subrogation, the insured must be made whole, taking into account comparative negligence, before the insurer may retain amounts it has recovered. Refer to the Wisconsin Supreme Court decision of Rimes vs. State Farm Mutual Automobile Insurance Company, 106 Wis. 2d 263. Your condition does not conform to this requirement.

    Refer to Conditions Applicable to Section I. Section 631.81, Wis. Stat., states that notice of loss should be made as soon as reasonably possible. Failure by the insured to give notice does not invalidate or reduce the claim unless the insurer is prejudiced by the failure to give notice. Your condition is contrary to this section.

    Refer to Conditions Applicable to Section II. Section 632.24, Wis. Stat., provides for, in part, that direct action against the insurer can be made irrespective of whether or not the liability is established by a judgment or trial. Your condition violates this section. Section 803.04, Wis. Stat., provides that the insurer can be joined in a court action against the insured. Your condition is contrary to this section.

2. For the following comment refer to forms:

    - CR 00 13 (ED. 10 83), Exclusion 2.C
    - CF 00 11 (ED. 01 83), Section VI – Perils Insured Against, item 8.E
    - CF 10 02 (ED. 10 83), Section I – Perils Insured Against, item A.1 and item D.4
    - MP 00 10 (Ed. 01 83), Section IV Perils Insured Against, item H.5
    - MP 00 12 (Ed. 01 83), Section IV Perils Insured Against, item H.5,

- MP 00 13 (Ed. 10 83), Section VII Exclusions, Item 2.C,
- FL-7(Ed. 8-80) AAIS, FL-6A (Ed. 8-80) AAIS,
- FR 00 01 07 81, FR 00 02 07 81, FR 00 03 07 81, FR 00 06 07 81, FR 00 08 07 81,
- DP-1 (2-82), DP-2 (2-82), DP-3 (2-82), DP-4 (2-82), and
- HO-1 (1-82), HOR-1 (1-82), HO-2 (1-82), HOR-2 (1-82), HO-3 (1-82), HOR-3 (1-82), HO-4 (1-82.

Refer to the vacancy exclusions. Section Ins 6.76 (3) (e) 2, Wis. Adm. Code, provides that coverage may be suspended or restricted while a described building is vacant or unoccupied beyond a period of 60 consecutive days. The forms listed above allowed for only a 30-day period of vacancy.

3. For the following refer to forms:

- CLU-FLU (6-95) – Farm Umbrella Liability Policy, and
- CLU-PLU (6-95) – Personal Umbrella Liability Policy.

Refer to Exclusion 3.g. Section 632.32(5)(b), Wis. Stat., provides that a policy issued to anyone other than a motor vehicle handler may limit coverage afforded to a motor vehicle handler to the limits required by the Wisconsin Financial Responsibility law and to instances when there is not other valid and collectible insurance (whether primary, excess, or contingent). Exclusion 3.g is contrary to this section.

Refer to exclusion 9. Section 632.32(6)(b)1, Wis. Stat., provides that persons related by blood or marriage to the insured may not be excluded from coverage or benefits. Exclusion 9 violates this section. You cannot exclude family members from coverage for auto liability coverage.

Refer to Condition J, Our Right to Recover Payment. In situations involving subrogation, the insured must be made whole, taking into account comparative negligence, before the insurer may retain amounts it has recovered. Refer to the Wisconsin Supreme Court decision of Rimes vs. State Farm Mutual Automobile Insurance Company, 106 Wis. 2d 263. Condition J does not conform to this requirement.

Refer to Conditions K, Suit Against Us. Section 632.24, Wis. Stat., provides for, in part, that direct action against the insurer can be made irrespective of whether or not the liability is established by a judgment or trial. Condition K violates this section. Section 803.04, Wis. Stat., provides that the insurer can be joined in a court action against the insured. Condition K is also contrary to this section.

4. For the following refer to forms:

- FR 00 01 07 81, page 12, Condition 8, Subrogation,
- FR 00 02 07 81, FR 00 03 07 81, and FR 00 04 07 81.

Refer to the subrogation conditions. The insured must be made whole, taking into account comparative negligence, before the insurer may retain amounts it has recovered. Refer to the Wisconsin Supreme Court decision of Rimes vs. State Farm Mutual Automobile Insurance Company, 106 Wis. 2d 263. Your provision does not conform to this requirement. This is the same for FR 00 02 07 81, FR 00 03 07 81, and FR 00 04 07 81.

Refer to the claim settlement conditions. Section 628.46 (1), Wis. Stat., states that interest is payable on claim payments not paid within 30 days of settlement of the claim. These forms allow 60 days before interest is payable. Your form violates this section.

5. For the following refer to form MO-12 (1-82):

   Refer to item 2.e. You state you will take the deductible from the limit of liability. The limit of liability is the most you will pay but the limit of liability is not subject to the deductible. Taking the deductible from the limit of liability is deceiving as then the limit would never be paid. This language should be clarified as it appears you will take the deductible from the limit.

6. For the following refer to:

   - Mobile Homeowners Supplement Application
   - Homeowners Application (which looks like a declarations page)
   - Coverage E – Unscheduled Farm Personal Property
   - Coverage D – Scheduled Farm Personal Property
   - Request for Endorsement
   - Solid Fuel Burning Appliance

   Refer to the heading or footing of the forms. These forms do not have form numbers. All forms, applications, etc. should have form numbers so changes can be tracked and approval obtained.

7. For the following refer to form PO-20 (2-82):

   Refer to Exclusion 1. Section Ins 4.01 (2) (h), Wis. Adm. Code, provides that real property owned and occupied by an insured which is partially destroyed but ordered destroyed under a fire ordinance or similar law, shall be considered wholly destroyed for purposes of the valued policy law, s. 632.05 (2) (a), Wis. Stat. Your form does not comply.

   Refer to Policy Conditions 2 and 3. Section 631.36, Wis. Stat, deals with cancellation, nonrenewal, and renewal with altered terms. A policy is required to contain provisions complying with this section which set forth the manner in which an insurer may cancel, nonrenew, or renew the policy with altered terms, including when notices must be sent or delivered to the insured. Your conditions appear not to comply.

   Refer to Policy Condition 10, Subrogation. In situations involving subrogation, the insured must be made whole, taking into account comparative negligence, before the insurer may retain amounts it has recovered. Refer to the Wisconsin Supreme Court decision of Rimes vs. State Farm Mutual Automobile Insurance Company, 106 Wis. 2d 263. Your provision does not conform to this requirement.

8. For the following refer to form HO-20 (1-82):

Refer to Exclusion 1. Section Ins 4.01 (2) (h), Wis. Adm. Code, provides that real property owned and occupied by an insured which is partially destroyed but ordered destroyed under a fire ordinance or similar law, shall be considered wholly destroyed for purposes of the valued policy law, s. 632.05 (2) (a), Wis. Stat. Your form does not comply.

Refer to item 2 under PAYMENT OF LOSS OR CLAIM. Section 632.24, Wis. Stat., provides for, in part, that direct action against the insurer can be made irrespective of whether or not the liability is established by a judgment or trial. Your form appears to violate this section.

Refer to CONDITIONS APPLICABLE TO ALL COVERAGES, item 2e and item 3. Section 631.36, Wis. Stat, deals with cancellation, nonrenewal, and renewal with altered terms. A policy is required to contain provisions complying with this section which set forth the manner in which an insurer may cancel, nonrenew, or renew the policy with altered terms, including when notices must be sent or delivered to the insured. Your conditions appear not to comply.

Refer to CONDITIONS APPLICABLE TO ALL COVERAGES, Item 10, Subrogation. In situations involving subrogation, the insured must be made whole, taking into account comparative negligence, before the insurer may retain amounts it has recovered. Refer to the Wisconsin Supreme Court decision of Rimes vs. State Farm Mutual Automobile Insurance Company, 106 Wis. 2d 263. Your provision does not conform to this requirement.

The policy forms above require changes in order to comply with insurance law. It is recommended that the company change the language in its forms in order to comply with the statute, administrative rule, or court decision cited in this section of the examination report. It is further recommended that the company file the changes in compliance with s. 631.20, Wis. Stats.

Agent force: The company currently requires a minimum annual amount of $10,000 for premium production for each agent. This amount appears low, as it does not encourage premium production by agents. It is recommended that the company increase its agent premium production requirements.

The company should also evaluate its agent force overall. This evaluation should include an analysis by agent of loss ratio, by line of business, and by territory to determine if the agent is profitable for the company. This should also include an evaluation of the cost related to servicing the agents. An evaluation of the agent agreement and the commission schedule should also be performed. It is recommended that the company perform an extensive evaluation of its agent force, which includes the items noted previously.

Insurance to value: The company inspects its risks on a nine-year cycle. In this time period, there could be many physical changes in the risk, changes in occupancy, valuation changes and so on. All of these changes could affect the loss potential characteristics of the risk that the company may not be aware of. In addition, the rate being charged could be affected by these changes in the risk. It is important that the company obtain more current underwriting information on each risk. An inspection program, which requires more frequent inspections of each risk insured, should be implemented. It is recommended that the company perform an extensive evaluation of its current inspection program, to include more frequent inspections of the insured risks.

It was also noted during the review of the underwriting function that the company frequently does not appear to insure its risks to the actual value of the risk. In the sample reviewed the coverage A values on the homeowners program ranged from $16,000 to $125,000. There were three files that showed Coverage A values of $23,000 to $28,000. The farmowners book of business showed similar low values for insurance coverage for dwellings; insurable values of $12,000 to $25,000 were common. Also, the company does not have an established procedure for determining the values for barns and outbuildings. The company indicated that a majority of these lower-valued risks are due to the insured requesting that amount of coverage. This is a serious problem for the company since this is a major portion of its book of business, there are potential legal issues with underinsuring risks, and sufficient premium is not generated to pay losses related to and the expenses related to servicing the risk. It is recommended that the company establish a procedure for determining the actual value of the risk to be insured. It is recommended that the company establish a plan for re-underwriting its book of business to achieve proper insurance to value and discontinue underinsuring at the insureds request, unless there is a written agreement with the insured regarding the underinsuring of the risk.

The homeowners program for this company does not provide any system to automatically update insurable values over time. To provide for increases in values due to inflation, and improvements in the property, it is recommended that the company establish an inflation protection program to automatically update values on the homeowners program on at least an annual basis.

Agent Commissions

The company pays agents three types of commissions. The largest of these are regular commissions paid for the business written or renewed by the agent for the company. These commissions range from 14% to 20% depending upon line of business. The company also pays a contractual contingent commission (also called agency profit-sharing commission). These commissions begin to reward the agent for an average direct loss ratio of about 58%. Finally, the company pays a bonus commission to agents meeting specified written premium increase requirements designated yearly at the discretion of the board. These commissions have ranged from 2.5% to 5% in the past five years.

The contingent commission is based on the volume of business credited to a particular agent (with a minimum $20,000 written premium requirement) and the three-year loss experience of this business. Since this commission is based upon loss experience, the actual amount is not determined until after year-end and an estimated amount is established for reporting purposes. For 1997, the company estimated $9,600 for contingent commissions. The actual amount paid was $14,188. An adjustment of $4,588 is being made and is reflected in the section of this report titled "Reconciliation of Surplus per Examination."

As noted above, the formula for the contingent commissions begins to reward an agent for an average direct loss ratio of approximately 58%. In the section of this report titled "Growth of Crystal Lake - Utica", the company's net expense ratio was reported as averaging 56%. Due to this high expense ratio, the company would show underwriting losses if it had a net 58% loss ratio. Therefore, paying contingent commissions to agents with an average 58% loss ratio exacerbates the poor financial results of the company. The company needs to evaluate the point at which it begins to reward agents for loss experience in light of its expense ratio.

Finally, the bonus commissions paid are discretionary; based on the increase in volume of business of a particular agent, without consideration of the operations of the company as a whole. The company has incurred operating losses in the past three years. While rewarding an increase in premium volume may be desirable, since the company as a whole is losing money, the company should also re-evaluate this practice.

Overall, the company needs to evaluate the commission payment criteria for all types of commissions, so that these commissions take into consideration not only the operations of the agent but the company's operating results as well. It is recommended that the company evaluate its agent commission program. This evaluation should include, but not be limited to, the following:

- the agent's volume, growth and loss ratio;
- the company's operating results, including its expense ratio;
- comparison to competitors' commission rates and requirements;
- trends in the industry that affect operations of the company, and
- the overall financial outlook of the industry.

Net Unpaid Losses

The prior examination noted a number of errors in the completion of Schedule P of the annual statement, thereby hindering the usefulness of the schedule in the analysis of loss reserves. A recommendation was made that the company correct Schedule P for the accident year 1995 and complete the schedule on a carry-forward basis. It appears that the company has attempted to come into compliance with this recommendation by correcting accident year 1995 and completing the schedule on a carry-forward basis; however, Schedule P does not appear to be completely accurate for year-end 1997. Examiners could not tie company-reported amounts on the individual schedules of Schedule P to the summary schedules or to company-generated reports substantiating the completion of Schedule P. Therefore, it is recommended that the company properly complete, in accordance with the NAIC Practices and Procedures Manual-Property/Casualty and the Annual Statement Instructions-Property/Casualty, Schedule P of the annual statement.

Liabilities

The company reports in its general ledger an aggregate amount for "Accounts Payable" which represents accounts payable, certain tax amounts, and a portion of loss adjusting expenses. It then allocates portions of this account to the applicable annual statement line items. However, the company did not properly allocate the amount, $407, for fire dues payable to the taxes, licenses, and fees line item. This amount was included with "Other Expenses." The amount is being reclassified; this reclassification is reflected in the section of this report entitled "Reconciliation of Surplus per Examination." The prior examination recommended that the company report these amounts, as well as "Amounts Withheld or Retained by Company for Account of Others," in accordance with the Annual Statement Instructions-Property/Casualty. The company has partially complied with this recommendation as the amounts for "Amounts Withheld or Retained by Company for Account of Others" was properly reported; however, "Other Expenses" and "Taxes, Licenses, and Fees" were still not correctly reported. It is recommended that the company properly report "Other Expenses" and "Taxes, Licenses, and Fees" in accordance with the Annual Statement Instructions-Property/Casualty.

Invested Assets

Several errors were noted during the review of Schedule D of the annual statement. First, the company did not complete Schedule D using the market values according to the Valuation of Securities manual. The prior examination recommended that this be done; therefore, it is again recommended that the company properly complete Schedule D of the annual statement using the market values of the securities as listed in the Valuation of Securities manual of the NAIC Securities Valuation Office.

Second, the company did not submit the proper filings to the NAIC Securities Valuation Office (SVO). The company, as a ch. 611 insurer, is required to file Securities Acquisition Reports (SAR) for all securities, which are not listed in the SVO manual. These securities should be given a "Z" designation by the company to indicate that they have not been filed. The company did not indicate a "Z" designation; however, the examiners' review noted instances where there was a rating reported on the annual statement but the SVO indicated that the security was not listed. The prior examination recommended that the company submit the proper filings; therefore, it is again recommended that the company submit the proper filings to the NAIC Securities Valuation Office for those securities not listed in the Valuation of Securities manual. It is also recommended that the company indicate those investments which have not yet been filed with a "Z" designation and a rating which can be substantiated by the company.

Third, proper completion of Schedule D requires the use of designations for the different securities (i.e., Preferred Stock: P1, P2, P3; Common Stocks: U, L). The company did not use these designations when completing Schedule D. It is recommended that the company use proper designations when completing Schedule D (i.e., Preferred Stocks: P1, P2, P3; Common Stocks: U, L) for all future annual statements.

Last, interest payment dates are recorded on Schedule D. These dates are used in the calculation of interest income due and accrued. Upon review, it was noted that these dates were not always correct. An adjustment is not being made, as the result of the improper dates did not result in a material error. However, it is recommended that the company properly report interest payment dates on Schedule D for the purpose of calculating interest income due and accrued.

Real Estate

The company's real estate holding consists solely of the home office building. According to the <u>Accounting Practices and Procedures Manual For Property/Casualty Insurance Companies</u>, companies must include in both its income and expenses an amount related to the rent charged to itself for the occupancy of its own building. While the company does report an amount for "self-rent" there was no documentation to show how it is computed. It is recommended that the company document and retain records of rental income and expense related to the rent charged for the space occupied by the company.

It was also noted that the company periodically rents out a portion of its office building to outside tenants. However, there are no written, signed agreements between the company and the tenant. At this time, there is only one tenant that uses the space infrequently; however, the company intends to seek tenants as a source of additional income to the company.

If this is the case, the company would be advised to have written, signed lease agreements. It is recommended that the company have written, signed lease agreements with all tenants, current and future.

Cash and Short-term Investments

The cash accounts maintained by the company were reviewed to determine if the company was properly complying with ch. 177, Wis. Stat., on escheatable items. The company did file the required reports to the State Treasurer's office. However, the review noted that the company had written an old uncashed check back into cash. An adjustment is not being made as the amount is immaterial. Proper accounting, which was discussed with company personnel, is to establish a liability for these escheat checks. It is recommended that the company establish a liability for escheatable funds and discontinue the practice of writing uncashed checks back to cash.

Furniture and Equipment

The examiners performed a review of the furniture and equipment held by the company to determine if proper accounting of these assets was performed. It does not appear that the company properly accounted for the purchase, disposal, and depreciation of copy machines during the period under examination. The amounts of the depreciation do not materially affect the overall financial position; therefore, an adjustment is not being made. However, the company should properly account for the disposal of furniture and equipment in accordance with generally accepted accounting principles. Therefore, it is recommended that the company properly account for the disposal of furniture and equipment in accordance with generally accepted accounting principles. It is further recommended that the company depreciate furniture and equipment on a consistent basis or establish guidelines for the type of depreciation to be followed.

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Permanent Surplus

To comply with the Stipulation and Order issued by the Commissioner, the company was to maintain a permanent surplus of $1,000,000. This was to have excluded any surplus aid received through reinsurance; however, this was amended during 1997 to include surplus aid. The company reported policyholders' surplus as of December 31, 1997 of $985,995. This amount is $14,005 below the permanent surplus amount required, without considering the impact of surplus aid. It was recommended in the previous examination that the company file a business plan with this office outlining steps to be taken to comply with the Stipulation and Order. While the company has filed a "plan," as noted in a previous section of this report, entitled "Business Plan," this "plan" is not adequate. A more detailed recommendation was made in the previous section; therefore, the recommendation of the previous examination will not be repeated here.

VIII. CONCLUSION

Over the past five years, Crystal Lake-Utica's surplus has continued to decline; from $1,347,976 in 1993 to $985,995 in 1997. The company no longer meets its minimum permanent surplus requirement of $1,000,000. While loss experience continues to be unfavorable, the reinsurers have absorbed substantial portions of these losses. As a result, ceding commissions remain low resulting in expense ratios in excess of 50%. It is unlikely the company can generate positive results to correct its surplus deficiency without evaluating and restructuring its operations.

The current examination resulted in 35 recommendations, two of these repeated from the previous examination, one suggestion, one adjustment, and two reclassifications. The adjustment was a decrease to surplus of $4,588, resulting in surplus of $981,407. The recommendations related to inadequate or lack of sufficient accounting records and documentation, lack of sufficient underwriting procedures and controls, underinsuring risks, noncompliance on policy forms, insufficient business plan, lack of sufficient data on losses, concentration of functions in one individual, and general lack of procedures.

For the reasons noted above, it has been recommended the company retain consultants to assist in developing a business plan and to evaluate its existing reinsurance program.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Annual Statement — It is recommended that the company properly complete the jurat page of the annual statement by including all directors and officers of the company.

2. Page 23 - Corporate Records — It is recommended that the company maintain minutes for committee meetings and that the minutes be approved by the board of directors and included with the minutes of the board of directors meetings.

3. Page 23 - Corporate Records — It is further recommended that the company appoint committees to carry out a purpose and that these committees have meetings.

4. Page 24 - Corporate Records —It is recommended that the company either amends its bylaws, with member approval, to reflect the actual nomination procedure followed, or follows the procedure as outlined in the bylaws.

5. Page 24 - Corporate Records — It is recommended that the company follow the procedures established in the bylaws for filling vacancies on the board when/if a vacancy should occur in the future.

6. Page 24 - Conflict of Interest — It is recommended that the company's directors and other key employes disclose all potential conflicts of interest on the conflict of interest statement disclosures.

7. Page 25 - Executive Compensation — It is recommended that the company properly complete the Report on Executive Compensation and include all amounts paid to directors and officers.

8. Page 26 - Business Plan — It is recommended that the company establish a formal business plan, which includes the items noted in the preceding paragraphs, that is reviewed and approved by the board of directors.

9. Page 26 - Business Plan — It is suggested that the company hire an outside consultant to assist in devising the business plan.

10. Page 26 - Budget —It is recommended that the company implement a budget in conjunction with the business plan, both of which should be periodically reviewed and approved by the board of directors and compared with actual results.

11. Page 26 - Audited Financial Statements — It is recommended that the company, in accordance with s. Ins 50.08 (2), Wis. Adm. Code, either require the accounting firm to rotate the partners engaged to perform the audit, request an exemption from the rotation requirement on the basis of unusual circumstances, or obtain a different certified public accounting firm to perform the audit.

12. Page 27 - Audited Financial Statements — It is recommended that the company and its accounting firm comply with s. Ins 50.11, Wis. Adm. Code, by properly reporting, to all relevant parties, adverse financial conditions of the company.

13. Page 27 - Audited Financial Statements — It is recommended that the company comply with s. Ins 50.06, Wis. Adm. Code, and properly include all required footnotes to the financial statements in accordance with the NAIC Annual Statement

Instructions-Property and Casualty and with generally accepted accounting principles.

14. Page 28 - Reinsurance — It is recommended that the company retain a reinsurance consultant to analyze and evaluate the current reinsurance program, loss patterns, and claims database and to assist the company in developing a reinsurance program that would provide the company with the following: coverages as required by the Order, sufficient loss protection, sufficient retention levels, and adequate ceding commissions to account for related expenses.

15. Page 29 Underwriting - It is recommended that the company revise its underwriting criteria to remove the use of the age of the dwelling as a criteria necessary to gain coverage under its various plans of insurance, in accordance with Ins. 6.68(3)(b), Wis. Stat.

16. Page 32 Underwriting - It is recommended that the company change the language in its forms in order to comply with the statute, administrative rule, or court decision cited in this section of the examination report.

17. Page 32 Underwriting - It is further recommended that the company file the changes in compliance with s. 631.20, Wis. Stats.

18. Page 32 Underwriting - It is recommended that the company increase its agent premium production requirements.

19. Page 32 Underwriting - It is recommended that the company perform an extensive evaluation of its agent force, which includes the items noted previously.

20. Page 33 Underwriting - It is recommended that the company perform an extensive evaluation of its current inspection program, to include more frequent inspections of the insured risks.

21. Page 33 Underwriting - It is recommended that the company establish a procedure for determining the actual value of the risk to be insured.

22. Page 33 Underwriting - It is recommended that the company establish a plan for re-underwriting its book of business to achieve proper insurance to value and discontinue underinsuring at the insureds request, unless there is a written agreement with the insured regarding the underinsuring of the risk.

23. Page 33 Underwriting - It is recommended that the company establish an inflation protection program to automatically update values on the homeowners program on at least an annual basis.

24. Page 35 Agent Commissions - It is recommended that the company evaluate its agent commission program. This evaluation should include, but not be limited to, the following:

- the agent's volume, growth and loss ratio;
- the company's operating results, including its expense ratio;

- comparison to competitors' commission rates and requirements;
- trends in the industry that affect the operations of the company, and
- the overall financial outlook of the industry.

25. Page 35 Net Unpaid Losses - It is recommended that the company properly complete, in accordance with the NAIC Practices and Procedures Manual-Property/Casualty and the Annual Statement Instructions-Property/Casualty, Schedule P of the annual statement.

26. Page 36 Liabilities - It is recommended that the company properly report "Other Expenses" and "Taxes, Licenses, and Fees" in accordance with the Annual Statement Instructions-Property/Casualty.

27. Page 36 - Invested Assets — It is again recommended that the company properly complete Schedule D of the annual statement using the market values of the securities as listed in the Valuation of Securities manual of the NAIC Securities Valuation Office.

28. Page 37 - Invested Assets — It is again recommended that the company submit the proper filings to the NAIC Securities Valuation Office for those securities not listed in the Valuation of Securities manual.

29. Page 37 - Invested Assets — It is also recommended that the company indicate those investments which have not yet been filed with a "Z" designation and a rating which can be substantiated by the company.

30. Page 37 - Invested Assets — It is recommended that the company use proper designations when completing Schedule D (i.e., Preferred Stocks: P1, P2, P3; Common Stocks: U, L) for all future annual statements.

31. Page 37 - Invested Assets —It is recommended that the company properly report interest payment dates on Schedule D for the purpose of calculating interest income due and accrued.

32. Page 37 - Real Estate — It is recommended that the company document and retain records of rental income and expense related to the rent charged for the space occupied by the company.

33. Page 38 - Real Estate — It is recommended that the company have written, signed lease agreements with all tenants, current and future.

34. Page 38 - Cash and Short-term Investments — It is recommended that the company establish a liability for escheatable funds and discontinue the practice of writing checks back to cash.

35. Page 38 - Furniture and Equipment — It is recommended that the company properly account for the disposal of furniture and equipment in accordance with generally accepted accounting principles.

36. Page 38 - Furniture and Equipment —It is further recommended that the company depreciate furniture and equipment on a consistent basis or establish guidelines for the type of depreciation to be followed.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employes of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Mary C. Hynes	Insurance Examiner - Financial
Amy K. Kreif	Insurance Examiner - Financial
Norman Wirtz	Insurance Examiner - Market Reg
Fred Thornton	Insurance Examiner - Advanced

Respectfully submitted,

Kris DeArmond
Examiner-in-Charge

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